Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Request to Update Default Compensation Rate	)	RM No. 10568
For Dial-Around Calls from Payphones	)	
	)	

REPLY OF THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL

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INTRODUCTION AND SUMMARY

The American Public Communications Council ("APCC"), in its request for a rulemaking ("Request"), argued that the significant decline in call volumes from payphones requires that the Commission update the dial-around rate to ensure the continued widespread deployment of payphones as required by section 276(b)(1) of the Act. 47 U.S.C. § 276(b)(1). The drop in call volumes since 1998 has left payphone service providers ("PSPs") with no choice but to decommission large numbers of payphones. Failure to update the dial-around rate would result in a continued steep decline in the number of payphones as further drops in call volumes caused lower revenues, thus forcing PSPs to pull even more payphones. APCC's Request asks only for that to which PSPs are entitled, a dial-around rate that reflects changed circumstances. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Third Report and Order, 14 FCC Rcd 2545, 2647-48, ¶ 230 (1999).

Significantly, all of the commenting interexchange carriers commenting ("IXCs") admit that market conditions have changed. They agree that the growth in the popularity of wireless service has significantly reduced call volumes from payphones, thus forcing PSPs to decommission phones. This agreement is powerful evidence that the dial-around rate must be updated. Failure to update the rate in light of significant changed circumstances ensures that PSPs will *not* be "fairly compensated" for dial-around calls as required by Section 276(b)(1)(A) of the Act. 47 U.S.C. § 276(b)(1)(A).

Some IXCs suggest that despite the fact that circumstances have undeniably changed in the past few years, the rate should be left alone to let the marketplace operate freely. However, if the market for dial-around calls was truly free, PSPs would have increased the dial-around rate, just as they increased the coin rates. They were not free to do so. As a result, the current dial-around rate distorts the market since it no longer recovers a proportionate share of joint and common costs, thus forcing PSPs to recover a disproportionate share of their joint and common costs from coin callers.

Other IXCs, such as AT&T and WorldCom, appear to concede that the Commission should update the dial-around rate but argue that the Commission should issue a Notice of Inquiry ("NOI") first to build a record on, among other issues, how the payphone market has changed over the last few years. However, a NOI is inappropriate in this case. Unlike in the typical situation when an NOI is issued, the issues and objectives of a proceeding to update the dial-around rate are clear, and any factual issues that need to be addressed can be addressed in a rulemaking. Only the Commission can initiate a dial-around rate change proceeding; by issuing a NOI instead, the Commission would delay the adoption of a rule by at least six months to one year. In the meantime, more payphones will be pulled, more PSPs will go bankrupt and PSPs will continue to be compensated unfairly for dial-around calls, in violation of the Act.

A few IXCs argue that an increase in the dial-around rate will further reduce payphone revenues. However, the IXCs provide no evidence to this effect, and in any event, PSPs are free to charge less than the prescribed dial-around rate if they discover that the increase in the rate actually lowers revenue. In any event, the issue of demand elasticities is to be addressed in a rulemaking.

Finally, IXCs raise a host of other issues regarding the methodology and inputs used in APCC's cost study. The IXCs' arguments lack merit, but in any case, they again raise precisely the types of issues that should be addressed in a rulemaking and should not delay the issuance of a NPRM.

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REPLY OF THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL

Pursuant to the Commission's Public Notice[1] and 47 C.F.R. § 1.411, the American Public Communications Council ("APCC") hereby submits this reply to comments regarding APCC's request for a rulemaking ("Request") to update the rate for dial-around calls from payphones.

As explained by APCC in its Request, in setting the $.24 rate, the Commission stated that the rate would be in effect through January 31, 2002, after which a party could request the Commission to establish a new rate to reflect changed conditions. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* Third Report and Order, 14 FCC Rcd 2545, 2647-48, ¶ 230 (1999) ("*Third Report and Order*"). The comments filed in response to the requests of APCC and the RBOC Payphone Coalition confirm that conditions have significantly changed since 1999.[2] Thus, if anything, the comments filed in this proceeding highlight the need to update the dial-around rate.

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1 Public Notice, DA 02-2381, *Wireline Competition Bureau Seeks Comment on Petitions for Rulemaking Regarding Payphone Dial-Around Compensation*, RM No. 10568 (Sept. 30, 2002).

2 Comments on APCC's Request were filed by AT&T Corp. ("AT&T Comments"), Telstar International, Inc. ("Telstar Comments"), Global Crossing North America, Inc. ("Global Crossing Comments"), WorldCom, Inc. ("WorldCom Comments"), Sprint Corporation ("Sprint Comments"), IDT Corporation ("IDT Comments"), ATX Communications, Inc. ("ATX Comments"), and the Attorney General of The State of Texas ("Texas Comments").

I. THE DIAL-AROUND COMPENSATION RATE REQUIRES PERIODIC FCC REVIEW JUST LIKE ANY OTHER REGULATED RATE

Some interexchange carriers ("IXCs") argue that reexamining the dial-around rate is somehow inappropriate, regardless of the erosion of payphone deployment, because competitive market forces should be left alone to determine the appropriate level of payphone deployment. ATX Comments *et al.* at 5 ("market forces should allow for a decrease in the number of payphones when they do not provide a public benefit."); IDT Comments at 7 ("the marketplace will determine whether payphones are widespread"); WorldCom Comments at 10 ("The market . . . should be able to determine an appropriate level of supply"). Sprint charges that, in requesting an increase in the dial-around rate, PSPs are seeking "a public subsidy – in the form of inflated, FCC-mandated compensation that is divorced from market pressures." Sprint Comments at 8. Sprint even complains that dial-around compensation turns IXCs into forced consumers of payphone service. Sprint Comments at n.7.

The implication that dial-around compensation itself inappropriately disrupt the operation of an otherwise free market has nothing to do with reality, and is refuted by the historical record. First, no one has forced IXCs to become consumers of dial-around service. PSPs have never insisted that IXCs accept dial-around calls from payphones; on the contrary, it is the IXCs who have promoted dial-around calling, beginning in the late 1980s, in order to profit from coinless use of payphones without making any payment to PSPs. It was only after Congress compelled PSPs to allow dial-around calling from their payphones, that PSPs requested the Commission to prescribe compensation for a payphone service that the law compelled PSPs to provide. 47 U.S.C. § 226.

Thus, the "free market" that IXCs contend should be allowed to operate free of Commission intervention simply does not exist in the case of dial-around calling. PSPs are required by law to allow dial-around calling from their payphones, and have no way to ensure that IXCs make fair payment for their customers' use of payphones, other than by Commission-prescribed compensation. In short, dial-around *compensation* is not restricting the operation of a free market; rather, compensation is needed *because Congress* has restricted the free market. *IXCs* are not forced to be *consumers* of dial-around service – *PSPs* are forced to be *suppliers*.

Moreover, the IXCs have the unique ability to test the market by implementing call blocking, and thereby to ensure that they do not overpay for dial-around service – but they have chosen not to exercise that power. In the *Third Report and Order* the Commission recognized that, while PSPs are prohibited by federal law from blocking dial-around calling from their payphones, IXCs are not prohibited from declining to accept dial-around calls that reach their networks. By investing in targeted call-blocking technology, the Commission found, the IXCs could encourage the negotiation of dial-around compensation rates between PSPs and IXCs, limiting or eliminating the need for Commission intervention. *Third Report and Order* at 2647-48, ¶ 230. The Commission suggested that the IXCs invest in the necessary technology so that they would have the ability to refuse service in cases where a negotiated rate could not be reached. As the IXCs themselves admit, however, despite the Commission's encouragement, they have yet to invest in call-blocking technology that would enable them to exert market pressure on the dial-around compensation rate. Sprint Comments at n.7.[3] In light of the IXCs' refusal to invest in call-blocking that would provide IXCs the benefits of a market-based system, the IXCs should not now be heard to complain that Commission-prescribed compensation interferes with the free market in payphone service.

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[3] PSPs, for their part, requested the Commission to require IXCs to invest in call-blocking technology. The Commission denied this request in a recent order. *In the Matter of Implementation of Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Fifth Order on Reconsideration and Order on Remand, 2002 FCC LEXIS 5325, ¶ 109 (2002) (finding that the Colorado Payphone Association "raise[d] no new arguments or evidence sufficient to convince us that we should now impose targeted call blocking in response to its petition.").

At any rate, the simple fact is that the dial-around compensation rate is currently a regulated rate. Accordingly, there can be no rational basis for leaving the current $.24 rate in place when industry conditions and per-call costs *have* significantly changed. It is an axiom of common carrier regulation that regulated rates must be reexamined periodically, especially if underlying industry conditions have changed. Failure to permit updating of rates in the face of changed circumstances would conflict with the Act's requirement that rates be "just and reasonable." 47 U.S.C. § 201(b).[4] In the case of dial-around compensation, failure to update the rate would conflict with the fair compensation requirement of Section 276. 47 U.S.C. § 276(b)(1). In light of the dramatic and disruptive economic changes experienced by the payphone industry in the last few years, and the resultant changes in the per-call costs that justified the $.24 rate, the Commission must reexamine the dial-around rate promptly to ensure that it reflects recent and continuing changes in industry conditions. As APCC's cost study clearly shows, the current dial-around rate no longer suffices to recover the portion of a "marginal payphone's" joint and common costs that is allocable to dial-around calls. To bring the rate into line with per-call costs, it is clearly necessary to increase the rate; if any issue requires further comment, it is only the amount of the increase.

Finally, to the extent that signals from the payphone market can offer guidance here, they confirm that it is time to increase the dial-around rate. As reported by the RBOC Coalition – and by the IXCs themselves[5] – over the last year or so local coin rates increased significantly – typically from $.35 to $.50. This is an indication that market forces, if free to act, would put

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4 The Commission has gone to great lengths to update rates to ensure that they comply with Section 201 of the Act. For instance, the Commission's access charge regime is structured such that rates are updated automatically to reflect changes in costs. *See* 47 C.F.R. §§ 61.45 - 61.47.

5 IXCs agree that the rate for local coin calls has increased to $.50. *See, e.g.,* IDT Comments at 12; Global Crossing at 4.

upward pressure on dial-around rates as well. Moreover, as a result of the local coin rate increase, dial-around rates no longer recover a proportionate share of the joint and common costs of a payphone.[6] When costs are predominantly shared between a regulated and non-regulated service and the non-regulated rate increases significantly while the regulated rate remains fixed, that is a clear indication that the regulated rate is now too low. In light of the growing disparity between the dial-around rate and the local coin rate, the current dial-around rate can no longer be justified on the grounds that it mimics a market-based system. Thus, leaving the "cap" on the dial-around rate in place, far from being pro-competitive, is causing significant distortions in the market. In an unregulated market, the dial-around rate would have increased and fewer phones would be unprofitable.

II. THE COMMISSION MUST NOT DEFER A RULEMAKING ON THE DIAL-AROUND COMPENSATION RATE

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[6] The Commission, in the *Third Report and Order*, determined that the dial-around rate should be set so that dial-around calls recover a *proportionate* share of joint and common costs. The Commission explained that

> In the Second Report and Order, the Commission, in establishing a default compensation amount, found that *fair compensation required* that dial-around calls contribute a *proportionate* share of the common costs of payphone service. We continue to believe that this is an essential element of our determination of 'fair compensation' in this context. We find that any other approach would unfairly require one segment of payphone users to disproportionately support the availability of payphones to the benefit of another segment of payphone users. Such subsidies distort competition and appear inconsistent with Congress's directive to eliminate other types of subsidies.

Id. at 2570, ¶57 (emphasis added).

The Commission does not need to address the question of whether there has been a sufficient change in the payphone market to warrant a new proceeding on the dial-around rate. None of the commenting interexchange carriers ("IXCs") denies that call volumes have substantially decreased, or that declining usage has forced payphone service providers ("PSPs") to pull phones. Two of the IXCs affirmatively recognize there have been significant changes in the payphone market in the past few years. *See. e.g.*, WorldCom Comments at 8 ("Payphone market conditions have significantly changed since 1998"); AT&T Comments at 2 (acknowledging "changing market conditions").[7] The two largest IXCs, AT&T and WorldCom, also agree that a proceeding is needed and that the Commission should initiate review of the impact of such changes on the dial-around rate.

These and other IXCs argue, nevertheless, that the Commission should delay issuing a NPRM and should instead initiate a Notice of Inquiry ("NOI") to conduct a *de novo* review of its dial-around compensation methodology, or to reassess the policy of promoting payphone deployment. According to the IXCs, in light of the increasing prevalence of wireless phones, the Commission should not even begin a review of the dial-around rate until it has defined a new level of desired payphone deployment. AT&T Comments at 4-8; Sprint Comments at 7-9; WorldCom Comments at 2-18.

The Commission should recognize this argument for the diversionary tactic that it is. Issuing a NOI would serve no valid purpose here. An agency typically issues a NOI when it has

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7 The Consumer Protection Division of the Office of the attorney general for Texas is the only party that argues that payphone deployment levels may have remained constant over the past few years. This defies the readily verifiable experience of numerous PSPs. For example, even Sprint, which has payphone operations, admits that "over the last three years Sprint has removed or redeployed, in aggregate, about twenty percent of [its payphones]." Sprint Comments at 4. In addition, using Commission data, APCC calculated that from 1998 to March 2001 payphone deployment decreased by 10.5%. APCC's Request at 8, n.15.

no authority to adopt rules governing a subject matter, when it is uncertain as to the overall policy direction to follow, and/or when it has not yet identified the relevant issues sufficiently to provide adequate notice as to the nature of the regulations to be considered. *Compulsory Copyright License for Cable Retransmission*, Notice of Inquiry, 2 FCC Rcd 2387, ¶ 30 (1987) (purpose of the NOI is to gather information to help the Commission decide whether it should advise Congress to abolish the compulsory license for cable retransmissions); *Accounting for Phase-In Plans*, Federal Energy Regulatory Commission, Notice of Inquiry, 57 Fed. Reg. 13064, 13065 (1992) ("One of the principal purposes underlying the Notice of Inquiry was an effort to determine whether those involved with the industries subject to Commission regulation believed that a rulemaking was warranted, and what rules should be proposed"); U.S. Dept. of Commerce, National Telecommunications and Information Administration, *Comprehensive Review of Rate of Return Regulation of the U.S. Telecommunications Industry*, 51 Fed. Reg. 36837, 36840 (1986) (purpose of the NOI is to determine whether the costs of rate of return regulation are "sufficiently high to warrant replacement of rate of return regulation with an alternative system . . . ."). Under such circumstances, the Commission may seek to develop a factual record to make these threshold determinations. On the other hand, if the need for regulation and they type of regulation to be considered are already clear, there is no need for the Commission to conduct a preliminary investigation pursuant to a NOI. Under such circumstances, a NOI becomes counterproductive, wasting resources and introducing unnecessary regulatory delay.

In this case, the Commission's authority to prescribe regulations, the overall policy direction it is to follow, and the nature of the regulation to be considered are quite clear. Congress has spelled them out in Section 276. The Commission is authorized and *directed* "to prescribe regulations," to follow a policy of promoting "the widespread deployment of payphone services to the benefit of the general public," and specifically "to establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every . . . call." 47 U.S.C. §§ 276(b)(1), (1)(A). As Section 276's ratesetting directive is unconditional, and makes no mention of a preliminary inquiry, it is safe to conclude none was intended. Moreover, over the last six years, the Commission has acquired extensive experience in prescribing dial-around compensation rates. The Commission does not need a NOI to help it frame the relevant issues. Any additional facts that the Commission requires to decide whether and by what amount to increase the rate are more appropriately obtained in the course of the rulemaking itself. Accordingly, to defer an NPRM in favor of a NOI would unnecessarily and improperly waste time and commission and industry resources.

Time is an especially critical factor here, because of current industry conditions and because of the unusual statutory framework applicable to payphone compensation. In the typical Communications Act ratemaking process, when a carrier's underlying costs change, the carrier can initiate a responsive rate change merely by filing a tariff revision – which takes effect almost immediately unless the Commission takes affirmative action. If there are substantial issues concerning a carrier's underlying costs or cost methodology, those issues are addressed in a ratemaking hearing, in which the Commission can finally resolve the rate.

By contrast, no service-provider-initiated rate change process is available to PSPs. Instead, it is up to the Commission to begin a rulemaking to modify the dial-around compensation rate when conditions or costs have changed sufficiently to justify a change in the rate. As the entity entrusted by statute with the sole power to "ensure that [PSPs] are fairly compensated" in the absence of a functioning market mechanism, the Commission bears a particular responsibility to act promptly to reexamine the dial-around rate, upon reasonable request by PSPs.

Deferring a rulemaking by issuing a NOI would contravene the Commission's responsibility for prompt action. Inserting a NOI into the statutory payphone rate process would delay the Commission's review of the rate by an additional six months to a year, at minimum. Especially in the current circumstances, such a delay would conflict with and frustrate the statutory fair compensation scheme. The payphone industry is under tremendous economic stress, in part because dial-around rate has remained static or has been reduced while industry conditions worsened. Unnecessary delay in commencing a rulemaking would result in many more PSP bankruptcies, serious injury to the payphone industry, and acceleration of the current decline in payphone deployment.

The issues raised by the IXCs are not the kind of issues that require an NOI to resolve. Assuming for argument's sake that there is a need to reassess the Commission's methodology[8] or the optimum level of payphone deployment,[9] a NOI is not needed to enable the Commission to

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[8] The Commission should not be confused by the IXCs' specious attempts to cast doubt on the validity of the *Third Report and Order* methodology. For example, AT&T questions how it is possible that "the costs associated with a marginal payphone have remained essentially static, but . . . the number of payphone calls necessary to satisfy these essentially static costs has been reduced substantially." AT&T Comments at 9. What is happening in the payphone industry is not that difficult to explain: Payphone usage is falling, and therefore the price of calls must rise if a marginal payphone is to continue to "break even." To the extent that payphones "break even" with a lower number of calls than before, it is largely because increased rates for coin calls have enabled PSPs to recover the same revenue from a lower number of calls. Again, if the Commission does find it necessary to revisit methodological issues, they should be explored via the rulemaking that the PSPs have requested.

[9] APCC does not propose such a reassessment. APCC's cost study faithfully follows the Commission's *Third Report and Order*. The Commission, in the *Third Report and Order*, determined that the Act's requirement that the Commission promote the "widespread deployment of payphone services" was satisfied if the Commission set a dial-around rate that maintained the then-current level of deployment. *Third Report and Order* at 2610, ¶ 143. The rate proposed by APCC would maintain the current rate of deployment. APCC's rate would not return the industry to 1998 deployment levels (although the Commission has previously found the 1998 level to be the optimum level). APCC's cost study methodology produces a rate that aims to maintain existing "marginal payphones," not the payphones that were "marginal" in 1998.

make such an assessment. In the *Third Report and Order*, the Commission was able to determine, without the benefit of a NOI, that the then-current level of payphone deployment was consistent with Section 276 of the Act. *Third Report and Order* at 2610, ¶ 143. The Commission can revisit that determination, if necessary, in the context of a rulemaking by inviting comment on this issue, without resorting to a NOI and the attendant delay.

III. THE ISSUES RAISED BY THE IXCS DO NOT JUSTIFY DELAYING A RULEMAKING ON THE DIAL-AROUND RATE

Apart from the fact that a preliminary NOI is inherently inappropriate in the Section 276 context, the IXCs have failed to raise issues that even colorably justify delaying a rulemaking on the payphone rate.

A. A Higher Dial-Around Rate Will Limit, Not Accelerate Erosion of the Payphone Base

Some IXCs argue that the Commission would make matters worse for PSPs if it raised the dial-around rate. They argue that an increase in the dial-around rate would cause a further reduction in dial-around call volumes that would not be offset by the increased per-call revenues, thus causing accelerated removal of payphones. Global Crossing Comments at 1-6; AT&T Comments at 2, 5-6; IDT Comments at 12; ATX Comments at 2; Telstar Comments at 2-3. Global Crossing, which leads the charge on this issue, explains that call volumes and revenues would fall because "(1) as the cost of a good increases, demand for the good decreases and, if demand is elastic, total revenues will also decrease in response to a price increase; and (2) as the price of a good increases, other goods will be substituted for the good subject to the price increase." Global Crossing Comments at 3. Global Crossing argues that demand for dial-around calls is elastic. *Id.* at 5.

The elasticity issue raised by Global Crossing is a typical ratemaking issue. It is precisely the type of issue that, to the extent that it merits consideration, can be effectively addressed in a rulemaking.[10] There is no valid reason why the issue must be decided prior to initiating the rulemaking.

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[10] In fact, a good deal of information indicating that dial-around calls are price inelastic was provided to the Commission by economists on both sides, in the rulemaking that led to the *Third Report and Order*. The Commission considered the evidence at length and concluded that the (footnote continued on next page)

Moreover, the dial-around compensation scheme contains built-in safeguards against excessive and counter-productive rate increases. First, the dial-around rate set by the Commission is not a "floor". The Commission's regulations make clear that PSPs and IXCs are free to agree on a different rate. 47 CFR §64.1300(a). Like most businesses, PSPs are aware of the trade off between price and quantity, and can be expected to avoid charging IXCs the maximum permissible dial-around rate if they conclude that the maximum rate does not maximize revenues.

Second, the IXCs themselves can implement call blocking to encourage PSPs to agree to reduce the dial-around compensation rate, if they conclude that the rate could or does depress demand for their payphone-originated services. *See* discussion in Section I. above.

In addition, the suggestion that an increase in the dial-around rate will cause substantial acceleration in the substitution of wireless service for payphone service is both unsupported and implausible on its face. There is no reason to believe that dial-around calling is highly price-elastic. *See* Declaration of Don Wood, attached to this Reply, at ¶ 7 ("Wood Reply Dec."). Wireless service and payphone service are different products. While there is significant overlap in the consumer needs filled by these products, they have very distinct characteristics and therefore do not compete strongly with each other on the basis of prices. Payphone service is a dial-tone-on-demand, per-use-priced wireline service available twenty-four hours a day, seven days a week, 365 days a year. Users are not required to make an initial investment in equipment, await activation of the service or pay recurring monthly charges. Any member of the public can place a call anywhere at any time. On the other hand, wireless service is portable and convenient to use, but also has limitations. Its availability requires affirmative action by the user to transport

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precise elasticity of dial-around calling could not be reliably determined based on the evidence presented. *Third Report and Order* at 2589, ¶ 101-11.

the set, and sets are periodically or permanently non-functional in many geographic areas because of restrictions on the placement of cell towers. Also, unlike payphone providers, wireless providers generally charge subscribers a minimum fixed monthly fee, with a minimum term, for access to the wireless network.

As a result of the distinct product and price structure characteristics of payphones and wireless phones, they are by no means perfectly substitutable. A moment's reflection on the real differences between payphones and wireless phones is sufficient to recognize that the migration of usage that does occur between the two products has a great deal to do with (1) consumer preferences for particular product characteristics, (2) the fact that payphones are purchased strictly per use while cellular service must be purchased with an up-front fixed-price commitment, and (3) the increased affordability of such fixed-price cellular service packages.

B. PSPs Should Not Be Punished for the Decline in Call Volumes

A number of IXCs argue that declining payphone call volumes are the fault of PSPs, implying that PSPs should be punished by withholding any increase in the dial-around compensation rate. This is merely a diversion tactic. The fact remains that conditions have changed significantly since the *Third Report and Order* and that the dial-around rate needs to be updated accordingly.

1. The Increase In The Coin Rate Is Not Responsible For Lower Payphone Revenues

Some IXCs make the unsupported assertion that the increase in the coin rate is responsible for lower payphone revenues. IDT Comments at 12; Global Crossing Comments at 4. This is illogical in its face. As discussed in Section III.A. above, like most businesses PSPs are keenly aware of the tradeoff between payphone rates and call volumes. It should not be presumed that PSPs would increase the local coin rate if the result is decreased revenues. As explained above, the most likely explanation for declining call volumes is that callers have migrated from payphones to cell phones, primarily because they find cell phones more convenient and because the up-front costs of cell phones have become more affordable.

2. Poor Service Has Not Caused The Drop In Call Volumes

Some IXCs argue that poor service has caused or at least contributed to lower call volumes. IDT Comments at 10-11; WorldCom Comments at 11. However, IXCs offer no evidence to this effect. To the extent that some PSPs' quality of service has declined, a likely explanation is that reduced call volumes and revenues have forced those PSPs to spend less on maintenance and repair.

C. The Commission Should Not Revisit the Caller-Pays Issue

Apparently because it sees no benefit in the continued deployment of payphones,[11] Sprint recycles the arguments made in the last proceeding (and in every prior proceeding) urging the Commission to replace the current system of prescribed carrier-paid dial-around compensation with a "caller-pays" approach. Sprint Comments at 5-7. While advancing no new arguments,

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11 Sprint boasts that its payphone division has removed 20% of its payphones in the last three years, and castigates other PSPs for failing to move as quickly to exit the business. Sprint Comments at 3-5.

Sprint insists that this methodology is preferable to a cost-based methodology because it is "rational and efficient." *Id.* at 6. The Commission rejected this approach in the *Third Report and Order* and should not entertain it again here. As the *Third Report and Order* explained, "the statutory language and legislative history indicate Congress's disapproval of a caller-pays methodology." *Third Report and Order*, ¶ 115.[12]

Further, a caller-pays system would completely change the nature of dial-around calling and the nature of payphone service. The fundamental characteristic of toll-free calling is that it is "free" to the caller. A caller-pays system would turn toll-free calling into toll calling. Similarly, a fundamental characteristic of payphones, as they currently exist, is that they offer callers the option to make "coinless" calls. If the Commission institutes caller-pays, there would be no such thing as a coinless payphone call.[13]

By forcing payphone users to have coins on hand to make all payphone calls, a caller-pays approach would do far more than any rate increase to suppress demand for payphone service. The statutory mandate for widespread payphone deployment would be effectively repealed. The Commission should not give any further consideration to a system that would injure consumers and PSPs in equal measure, place statutory goals out of reach, and benefit no one.

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[12] The Senate Report provides that section 226(e)(2) bars the Commission from concluding that compensation for compensable calls must be paid by the caller. See S. Rep. No. 101-439 at 20 (1990). Section 226(e)(2) provides that "[t]he Commission shall consider the need to prescribe compensation (other than advance payment by consumers) for owners of competitive public pay telephones for calls routed to providers of operator services that are other than the presubscribed provider of operator services for such telephones." 47 U.S.C. § 226(e)(2).

[13] Under Section 226 of the Act, if a PSP requires advance payment for access code calls, it must require access code payment for "0" and "0+" "operator-assisted" calls as well. 47 U.S.C. §226(c)(1)(C). Therefore, under caller-pays, all coinless calling options would be eliminated.

IV. THE IXCS' OTHER OBJECTIONS TO APCC'S COST STUDY ARE INVALID, AND IN ANY EVENT CAN BE ADDRESSED AFTER THE COMMISSION ISSUES A NPRM

In addition to the diversionary issues discussed above, the IXCs raise a number of specific objections to APCC's cost study. Even more than the issues discussed above, these methodological and factual issues typify the kinds of matters that are routinely addressed in ratemaking proceedings, and that should be addressed, to the extent necessary, in a rulemaking; they are not relevant to whether the Commission *should open a rulemaking*. The critical point at this stage of the proceeding is that significant market changes require that the Commission adopt a new rule.[14]

In any event, the IXCs' objections have no merit. As discussed below, APCC's cost study followed the methodology of the *Third Report and Order* in all respects.[15]

A. APCC's Cost Study Correctly Identified Marginal Payphones

AT&T argues that APCC's cost study did not follow the methodology of the Commission's *Third Report and Order* with respect to the ascertainment of call volumes at a marginal payphone location. AT&T argues that the call volumes proposed by APCC are not based on the methodology reflected in the *Third Report and Order* because the study incorrectly

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14 WorldCom argues that current market conditions have drastically lowered PSP costs. WorldCom at 15. As evidence, WorldCom states that Davel, the largest independent PSP, experienced decreases in direct net costs of 31.1%, while sales, general and administrative expenses declined 37.5%. *Id.* WorldCom fails to inform the Commission, however, that these numbers reflect declines in Davel's total costs, not its costs per payphone. Of course, it is not at all surprising that Davel's total costs would have decreased over the past year since Davel has been decommissioning a large number of payphones.

15 *See* Wood Reply Dec, ¶¶ 5-6, 28. For those inputs for which the Commission found reliable data in 1999, we have provided updated data that is more reliable. For those inputs for which the Commission concluded it did not have reliable data in 1999, we have provided reliable data. For example, APCC's cost study included a value for the cost of collecting dial-around compensation from IXCs, and its call volume calculation factored in bad debt by counting only paid dial-around calls. APCC has fully justified the use of these input values in its Request at 13-15. *See also* Section IV C below.

identifies marginal payphones. AT&T Comments at 11-15. In particular, AT&T asserts that APCC incorrectly defines marginal payphones solely as those for which no commissions are paid to the location owner. *Id.* at 12. As a result, according to AT&T, the marginal payphones used in APCC's cost survey were not break-even phones as required by the Commission. *Id.* at 13.

AT&T's contention is simply wrong. APCC's cost study methodology excluded payphones for which the premises owner makes a payment to the PSP, as well as payphones for which the PSP pays the premises owner a commission. Wood Reply Dec., ¶ 14. Thus, APCC followed the Commission's *Third Report and Order* methodology closely. By excluding payphones where the premises owner pays the PSP, APCC insured that its cost methodology mirrored that of the Commission and that its marginal payphones excluded as many payphones that failed to break even as possible. Thus, AT&T's contention misses the mark.[16]

[16] There is also no validity to AT&T's argument that APCC's cost study must be validated with a top-down approach before they may be used. For a number of reasons, any results generated by a top-down methodology offer little insight at this time. Wood Reply Dec., ¶¶ 8-11, 27.

B. APCC's Survey Was Conducted in a Way that Minimized Potential Bias in Responses

Although AT&T alleges that the survey design of APCC's cost study had potential to elicit biased results, such concerns are unjustified. Declaration of Robert M. Bell at 5, ¶ 14. The response rate for the study was quite high (information on 408 out of 940 payphone locations for which information was sought was collected). Further, the instructions to respondents provided only general information about the purpose of the survey and stressed the need for accurate and unbiased information. Only Wood & Wood had contact with potential or actual respondents, and as Don Wood's Declaration (attached to these comments) testifies, the contact that occurred indicated no insight on the part of respondents into whether a higher or lower reported call count would impact the results in a "beneficial" way. Wood Reply Dec., ¶¶ 15-19.

C. Bad Debt

AT&T and others argue that APCC's study should not have taken account of bad debt.[17] They contend that the Commission's *Third Report and Order* ruling precludes any inclusion of bad debt. AT&T Comments at 17-18; ATX Comments at 14-15, IDT Comments at 15-16. In addition, AT&T argues that including bad debt would force some IXCs to pay costs properly allocable to other IXCs, contrary to *Illinois Pub. Telecomm. Ass'n v. FCC,* 117 F.3d 555 (D.C. Civ. 1997). AT&T Comments at 18.

In fact, in the *Third Report and Order* the Commission found that inclusion of bad debt was unwarranted because the record did not include information adequate to quantify the level of bad debt. APCC has addressed that issue by including in its determination of call volumes only those calls for which PSPs were actually compensated. This approach also addresses any

[17] WorldCom, however, acknowledges that a cost element for bad debt may be permissible. WorldCom Comments at n. 22.

concern on behalf of IXCs who pay 100% of their compensation. Under APCC's method, costs would be divided equally among every coin call, every other compensable call, and every paid dial-around call, thus ensuring that no paid call is allocated more than its share of joint and common costs.

D. Interest

AT&T also objects to APCC's inclusion of a cost element for four months' interest at 11.25%. AT&T Comments at 19-20. This is exactly the approach followed in the *Third Report and Order*, and recently reaffirmed by the Commission. *Third Report and Order* at 2630-31, ¶¶ 187-189; *In the Matter of Implementation of Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Fifth Order on Reconsideration and Order on Remand, 2002 FCC LEXIS 5325, ¶ 30-32 (2002). The Commission provided a reasonable justification for this approach and need not revisit it.

E. Capital Costs

The IXCs also find fault with the APCC study's treatment of capital costs. WorldCom contends that APCC incorrectly relied on historic, rather than forward-looking costs. WorldCom Comments at 16. In fact, as the Declaration of Don Wood explains, APCC used forward-looking costs. Wood Reply Dec., ¶ 21.

WorldCom also claims that in light of the decline in the payphone base, the cost study should have based its estimate of capital costs on the use of used payphones. *Id.* This is inconsistent with WorldCom's complaint about the allegedly poor quality of payphone service. If PSPs can maintain marginal payphones only by recycling used equipment, such cost cutting measures can only reduce the quality of service. *See also* Wood Reply Dec., ¶ 22.

Moreover, APCC's estimates for capital costs reflect the widespread availability of used payphone equipment at depressed prices. Basic economic theory tells us that the prices of new goods reflect the availability and prices of used goods. Thus, the prices for new payphone equipment are disciplined by and reflect the prices for used payphone equipment. Because of the relationship between the prices of used and new equipment, prices for new payphone equipment will be relatively low.

F. The Commission May Not – and in Any Event Should Not – Consider Non-Telecommunications Costs and Revenues

Some IXCs suggest that APCC's cost study is flawed because it did not include advertising revenues or internet kiosk revenues as an offset to the costs of marginal payphones. IDT Comments at 16; WorldCom Comments at 11. The Commission is not permitted to take advertising or other non-telecommunications sources of revenue into account in this or any other cost-recovery proceeding. A primary purpose of the Commission's *Computer III* order[18] was to separate a company's regulated and unregulated activities to "guarantee that regulated revenue properly follows regulated costs, and unregulated revenue follows unregulated costs." *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Order on Remand and Notice of Proposed Rulemaking, 17 FCC Rcd 3248, 3268, ¶ 53 (2002). The IXCs', however, are attempting to do just the opposite by matching up PSPs' unregulated revenue with their regulated costs. PSPs' advertising revenues have absolutely nothing to do with PSPs' regulated activities and are irrelevant to this proceeding. The Commission can no more consider PSPs' advertising revenues in setting the dial-around rate than it can consider a local exchange carrier's non-telecommunications revenue

18 *Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, Report and Order, 104 F.C.C.2d 958, 1086 (1986).

in a rate of return proceeding. Moreover, as explained below, if the Commission did consider non-telecommunications revenue, it would increase the complexity of the cost study exponentially. Rather than simply calculate the costs associated with placing payphone calls, the Commission would be in the unenviable (and impossible) position of also having to estimate the costs associated with PSPs' non-payphone operations. The Commission should not be in the business of constructing cost models for unregulated activities.

1. Advertising Revenues

The information available to APCC indicates that advertising has become a substantial factor in payphone revenue in only a few extremely narrowly defined central city areas such as New York City. In a few other markets, use of advertising by independent PSPs has been tried but does not currently exceed a couple of hundred payphones in each market. In other markets, use of advertising by independent PSPs is even more limited, if it exists at all.

There are a number of factors that currently limit the use of payphones for advertising purposes. First, to be effective, ads generally must be placed in areas with very high concentrations of pedestrian traffic. That is why the only markets where advertising has had any clear success to date are certain central business districts such as mid- and lower Manhattan. Almost by definition, areas with sufficient pedestrian traffic will not be marginal payphone locations.

Second, curbside payphones frequently require the consent of the municipality involved, and placement is often subject to costly administrative procedures and/or burdensome regulations. Revenue from a "marginal" payphone location is unlikely to justify the cost and hassle of dealing with such procedures and regulations.

Third, advertising is associated with relatively high-cost payphone locations. Ads are typically placed at curbside phones, for maximum effect; however, curbside phones are expensive to install because of the additional installation charges incurred to run wire to the phone. In addition, the booths used for advertising are themselves expensive. These additional costs are also likely to prevent the use of advertising in marginal locations.

For all these reasons, marginal payphone locations are very unlikely to be selected for advertising, and there is thus no reason to expect any significant advertising revenue to be available in any such locations. Even marginal locations could qualify for advertising placement, the percentage of payphones that currently have advertising is so small that the inclusion of the revenue would not significantly affect the result of the study.

In addition, the costs of payphones that include advertising posters have very different costs than those that do not. To accommodate advertising, payphones need to have a completely different and more expensive booth. APCC's cost study does not include marginal payphones that have these more expensive booths. It would be anomalous for the Commission to consider the revenues generated by payphone advertising but not take into account the higher equipment costs associated with that advertising.

Moreover, not only would considering advertising revenue be inconsistent, it is also impermissible.

2. Internet Revenues

The IXCs' claim that internet revenues should somehow be factored in is not supported by data indicating the extent of deployment of public internet terminals. WorldCom Comments at 12-13; IDT Comments at 13; Telstar Comments at 5. Based on the information available to it, APCC finds no reason to project that internet terminals will account for a significant percentage of the payphone base in the near term. As internet terminals are particularly unlikely to be deployed at marginal payphone locations, there is no reason to expect that, even when substantial numbers of such terminals are deployed, they would affect the costs or revenues involved in marginal payphone locations.

Moreover, as is the case with the facilities of payphones that accommodate advertising, internet facilities have a completely different cost structure and are significantly more expensive than regular payphone facilities. Payphones that offer internet service have computer screens, key pads and a host of other equipment that completely change the nature and cost structure of the payphone operation. As explained above, those costs are not reflected in APCC's cost study since none of its marginal payphones offer internet service. It makes little sense for the Commission to consider internet revenues on the one hand, but ignore internet facilities' far greater expense on the other. Doing so would force the Commission to immerse itself in PSPs' operations that have nothing to do with telecommunications services. In any event, as discussed in Section 'F' above, the Commission cannot consider PSPs' non-telecommunications revenue when setting the dial-around rate.

V. IXCS' OTHER OBJECTIONS ARE IMMATERIAL AND MERITLESS

IXCs' also allege that a rate increase would result in a higher rate of fraud. They provide no evidence, however, that there is any significant level of fraud associated with payphone compensation. The few cases cited do not raise any concerns substantial enough to affect the Commission's decision on raising the dial-around rate, and could not possibly provide any cause for delay in issuing a NPRM.

Finally, IXCs suggest that the need for a regulated compensation rate could be obviated by the future deployment of machines or kiosks selling prepaid disposal cell phones. Again, IXCs provide no statistics indicating that significant deployment of such products is imminent or that it would have any significant effect on the public need for payphones or the Commission's ability to satisfy the Congressional mandate for fair payphone compensation.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on November 14, 2002, the foregoing Reply of the American Public Communications Council was delivered via first-class U.S. Mail, postage pre-paid to the following parties:

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